

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Barbara Sharatz on April 27, 2006

DATED: April 27, 2006

On April 27, 2006, Sharon Blaskey and Michael Shapiro, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Barbara Sharatz from the City of San Diego Metropolitan Wastewater Department, at the City Administration Building, 202 C Street in San Diego, in a conference room on the third floor. Johnny Giang and Tammie Davis from KPMG also attended the latter part of the interview. Ms. Sharatz was not represented by counsel.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Barbara Sharatz, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Ms. Blaskey informed Ms. Sharatz that we are counsel to the Audit Committee and do not represent her or any employee. She advised Ms. Sharatz that the interview may be considered attorney work product and confidential, but the decision of whether to keep it confidential will be made by the Audit Committee in the best interests of the City, not by Ms. Sharatz personally. She said that it is important for Ms. Sharatz to keep the contents of the interview confidential to maintain the integrity of the process. Ms. Blaskey said that we will create a report which may contain statements of interviewees, and this report will likely be provided to KPMG and ultimately made public. She said government agencies may review the report and may be provided with additional information so it is important to be truthful and accurate.

Background

Ms. Blaskey asked Ms. Sharatz to describe her professional background. Ms. Sharatz said that she began working for the City on March 4, 1987, as a chemist for industrial waste inspection, and worked in that position until 1992. In that job, she worked on enforcement of Federal pretreatment standards regarding wastewater discharges from businesses. In 1992, she became a Permit Supervisor of the Industrial Wastewater Control Program, reporting to Rod Rippel, and edited the permits but did not work in the field anymore. In 1998, she became Program Manager of the Industrial Wastewater Control Program. In this position, her job was to ensure industries were complying with permits, and to issue compliance and penalty orders. She reported to Alan Langworthy. This role differed in that she was more responsible for final

decisions and more involved with people at policy making levels. Industrial wastewater control inspectors and supervisors reported to her.

One of the functions within her purview was for inspectors to do audits on-site at industrial locations. The inspectors established a percentage of return for water losses, also known as flow. For large users, the inspectors obtained samples and calculated flow based on the prior year's data. For industrial users, inspectors focused on SIUs, Significant Industrial Users, which were users that disbursed more than 25,000 gallons of sewage per day. Large industrial users include Sony, Kelco, pharmaceutical companies, laundries, membrane manufacturers, and beverage manufacturers.

State Guidelines

Ms. Blaskey asked Ms. Sharatz whether she was familiar with the State Water Resources Control Board Guidelines. Ms. Sharatz expressed familiarity with some parts of the State Water Resources Control Board guidelines. Ms. Blaskey asked Ms. Sharatz of her knowledge of requirements to incorporate COD into the sewer rate structure. Ms. Sharatz said she is aware that the City is "supposed to" incorporate COD into the rate structure "because of the State."

COS Kick Off

She volunteered that she attended a kickoff meeting for the rate study which was held in Corry Mason in 1998/1999. She was there to provide data to the consultants regarding industrial dischargers. She said she knew little about rates prior to the meeting but recalled discussions at this meeting about single family residential rates.

Ms. Sharatz was shown Exhibit 1, a May 3, 2000 email from Eric Adachi to Barbara Sharatz, Bill Hanley, Christine Ruess, and others re: "Cost of Service Study Kick-off Meeting" (COS002195). Ms. Blaskey asked Ms. Sharatz if this is the kickoff meeting to which she referred earlier. She said the email is not about the meeting she recalled attending in 1998/1999. She did not attend this meeting because the meeting she recalled was at a different place and no food was served. She noted that she did attend a meeting in 2003.

Ms. Blaskey asked Ms. Sharatz to describe what happened at the kick off meeting she attended in 1998-1999. She recalled that at the 1998-1999 meeting, the two consultants in attendance were Prabha Kumar and Sudhir Pardiwala. Gloria (the sewer classification supervisor who inputted changes into the computer to implement billing changes), Corinne Smith (Gloria's supervisor), and Eric Adachi also attended. Adachi sent her the Black & Veatch proposal and background information prior to the meeting. She added that Dennis Kahlie may have attended the meeting. The meeting's purpose was to get to know one another and learn about each person's role with the Cost of Service Study (hereinafter "COSS"). She noted that the COSS was being done to begin a process of implementing COD into the City's rate structure. At the 1998/1999 meeting, Sudhir spoke about different ways to construct rates and mostly spoke about rate structures in the context of single family residences.

Ms. Blaskey asked Ms. Sharatz if COD was addressed at the meeting in 1998/1999. She replied that she is confident that at the 1998-1999 kick off meeting, COD was

discussed because the purpose of the study was incorporating COD. COD involves different classes of users and she recalled a discussion about single family rates in the context of adding COD.

COS Post-1998/1999

Ms. Blaskey asked Ms. Sharatz what happened with the COS after the 1998-1999 meeting. She recalled that after the meeting, she received periodic requests for information for the COS. She did not hear any more about the COS but could not be sure no progress was being made because she was not involved. She understood that time was passing and there was no incorporation of COD but did not know why. She did not attend another meeting regarding these issues and was surprised she was not more involved. She knew the COS went to the Stakeholders' Group but had no involvement with it.

Ms. Sharatz was shown Exhibit 2, an April 29, 2003 email from Ms. Sharatz to Eric Adachi re: "Sewer Cost of Service Study Update." She did not recall sending it. Ms. Blaskey asked Ms. Sharatz to explain what is being discussed in Exhibit 2. She replied that her department was adding COD to some monitoring requirements for the permits and the industries were calling and inquiring about COD. She decided to add COD to the monitoring already being done. Not everyone was monitored until the new rate structure was approved. She did monitor Kelco and received periodic requests from Kelco for data. Kelco knew its COD was being monitored and it also monitored its own effluent for COD. She provided data to Kelco and, if required by permit, Kelco would provide data to Ms. Sharatz.

Ms. Blaskey asked Ms. Sharatz whether she heard discussion about implementing COD in the 2000-2003 timeframe. Ms. Sharatz said that from 2000-2003, she heard some discussion about COD incorporation, and she received data requests. She only learned of delays in implementing COD to the sewer rate structure by reading the City Attorney's Interim Report regarding sewer rates. She understood from Adachi that there were delays but was told that she should keep obtaining data so that they would be prepared when COD was incorporated. Ms. Blaskey asked Ms. Sharatz for her reaction to the words in Exhibit 2, "forced to implement." She responded that she knew the City was supposed to implement COD at some point but did not think anything unusual was going on. She did not know the reasons for the delays. Ms. Blaskey asked Ms. Sharatz if the delays in implementing COD were unusual. She replied that she never worked on another rate structure so she has no way of knowing how long implementation of a COS usually takes. She does not know of any deadline to incorporate COD and did not discuss the issue with Langworthy.

Ms. Blaskey asked Ms. Sharatz how she first became aware that the COS was complete. Ms. Sharatz said that Dave Nagle from her area told her he received a mailing regarding new sewer rates and Nagle called the sewer department and requested the COS. She then saw the COS and reviewed it because she was curious as to what it said. Her primary interest was what the COS said about industries because that is her job responsibility. The COS related that the City had to add COD to even more industries and begin monthly flow reporting for all large users.

Kelco

Ms. Blaskey asked Ms. Sharatz about her knowledge of Kelco. Ms. Sharatz said that Kelco was a single entity in 1987 but now is both ISP and CPKelco. ISP does kelp harvesting, is no longer operating in San Diego, and has relocated to Scotland. She did not know why ISP left but she heard speculation that the company left because of the changes in the rates and rate structure (in 2004).

Regarding Kelco's involvement with the rate structure issues, she said she interfaced with Kelco, including David McKinley from ISP and Ron Halik from CPKelco. She had conversations with McKinley in which he communicated his views about the City incorporating COD into the rate structure. McKinley was in the Stakeholders' Group and felt that since Kelco's discharge was going to Point Loma and Point Loma was not treating for COD, Kelco should not have to pay for treatment that its waste was not directly receiving. Ms. Sharatz noted that there was an option to construct rates individually or systematically and she understood that the City was going forward with a system-wide rate structure. When she read the City Attorney's Interim Report on Wastewater, she saw a letter from McKinley in which he asked the City for help, and was surprised to see it.

Ms. Blaskey asked Ms. Sharatz if she spoke with Kelco after the new rate structure was approved. She is sure she had a conversation with McKinley after the new rate structure was approved. She worked on a cost differential regarding Kelco and it is "highly likely" she spoke with McKinley about it. Alan Langworthy (Deputy Director, MWWDD) asked her to work on the differential because the City wanted to know how much the new rate structure would cost Kelco. She said that Kelco had threatened to leave the City in the past because they could not afford to stay.

Ms. Sharatz was shown Exhibit 3, a November 17, 2003 email from Ms. Sharatz to Alan Langworthy re: "Kelco Loading Effects" with attached spreadsheet. Ms. Blaskey asked Ms. Sharatz to explain the document's contents. Ms. Sharatz said that she prepared Exhibit 3 for Langworthy and thinks it had to do with the COS. She provided similar information regarding the COS in the past. She stated that Exhibit 3 reflects Kelco's COD, flow and SS.

Ms. Blaskey asked Ms. Sharatz about her familiarity with Doug Sain and whether Kelco was a supporter of the Mayor and/or Council. Ms. Sharatz stated that she is not familiar with Mr. Sain and is not aware of Kelco supporting the Mayor or Council.

Involvement in Disclosures

Ms. Blaskey asked Ms. Sharatz about her level of involvement with rating agencies or bond disclosures. Ms. Sharatz stated she had no involvement with the rating agencies or bond disclosures.

Delimex

Ms. Sharatz was shown Exhibit 4, a June 19, 2003 email from Eric Adachi to Ms. Sharatz re: "Delimex questions" with attached questions and answers regarding the City's sewer rate structure. Ms. Blaskey asked Ms. Sharatz what Delimex was. Ms. Sharatz responded that

Delimex is a food manufacturer in Otay Mesa and its headquarters is in Pennsylvania. The company had already been billed but then it was found to have a higher TSS level. It was fighting against an increase in its billing and wanted documentation concerning the increase in charges.

Conclusion

Ms. Blaskey requested that Ms. Sharatz keep the interview confidential to protect the integrity of the investigation and requested that Ms. Sharatz contact us if she recalls any information relevant to our investigation.

WF&G

3239194.1

EXHIBIT 1

From: Eric Adachi
To: Barbara Sharatz; Bill Hanley; Christine Ruess; ...
Date: 5/3/00 4:04PM
Subject: Cost of Service Study Kick-off Meeting

The cost of service and rate design project kick-off meeting has been scheduled for Tuesday, May 9 at 10 am in the 7th floor CAB small conference room. We plan to work through the lunch hour, so sandwiches and drinks will be provided. We are hoping to be done by 2:00 pm but may go longer.

Please let me know if you will be able to attend and also let me know if you have any special diet needs (ie vegetarian sandwich, etc.)

Thanks,
Eric

EXHIBIT 2

267584p
273917

Wastewater Hot 3-15-06

Email message text

Object type: [GW.MESSAGE.MAIL]

Item Source: [Received]

Message ID: [3EAE94F2.CCP.TREASURE.100.1383633.1.4650.1]

From: [Barbara Sharatz]

To: [;Eric Adachi;EAdachi@sandiego.gov]

Subject: [Re: Sewer Cost of Service Study Update]

Creation date: [4/29/2003 3:06:21 PM]

In Folder: [COS Update]

Attachments: None

Message: [

Thanks, Eric! -B

>>> Eric Adachi 04/29/03 02:22PM >>>

Thanks for the data. In terms of progress on COD billing, the answer is unfortunately, unknown. There hasn't been any action on this and it seems to have taken a back seat for now. At some point the City will be forced to implement it and we'll be ready. I'll let you know if I hear anything definitive on it.

Eric

>>> Barbara Sharatz 04/28/03 03:48PM >>>

Eric: Here's the data you requested by facility, then sewer connection....some facilities have more than 1sewer connection. What progress, if any, have we made on billing based on COD?? I have been advising some industries that we are planning to incorporate COD in the billing matrix in the near future in order to compy with state revenue guidelines. -Barbara

]

273916p

EXHIBIT 3

520590

WW Hot 02_16_06

Email message text

Object type: [GW.MESSAGE.MAIL]

Item Source: [Received]

Message ID: [3FB9054A.MWWD.MW-MOC.100.1783076.1.790D.1]

From: [Barbara Sharatz]

To: [;Alan Langworthy;ALangworthy@sandiego.gov]

Subject: [Kelco Loading Effects]

Creation date: [11/17/2003 5:28:42 PM]

In Folder: [Mail Box]

Attachment File name: [C:\44932MWM\ALangworthy\2746.1-TEXT.htm]

Attachment File name: [C:\44932MWM\ALangworthy\2746.2-Kelco Effects Final.xls]

Message: [

Alan:

Please see the attached file, and call to discuss or if you need further information. -Barb

]

WASTEWATER0004303

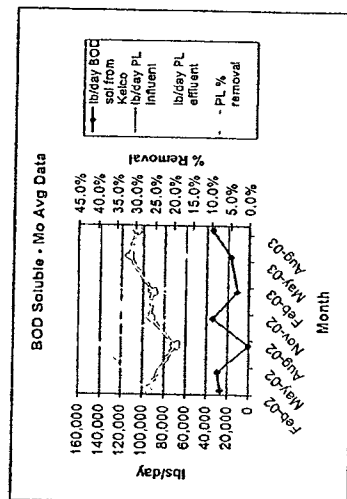
5205

WW Hor 02_16_06

WASTEWATER0004305

Monthly Average Values and Flows

	lb/day BOD sol from Kelco	lb/day PL Influent	lb/day PL effluent	PL % removal
Aug-03	34,423	131,050,5066	108,746,916	18.7%
May-03	17,591	135,810,485	112,985,316	16.7%
Jun-03	11,136	118,465,547	91,343,85	22.8%
Oct-02	33,896	121,296,4612	93,231,6924	23.1%
Jun-02	321	113,485,5492	89,157,4484	39.1%
Apr-02	28,977	125,650,9404	84,482,0316	32.8%
Feb-02	26,639	129,523,376	94,931,8848	26.5%
Average	21,849	124,984	93,244	25.7%
Median	26,639	125,651	93,232	23.1%
Maximum	34,423	135,810	112,985	39.1%
Minimum	321	113,466	69,157	16.7%

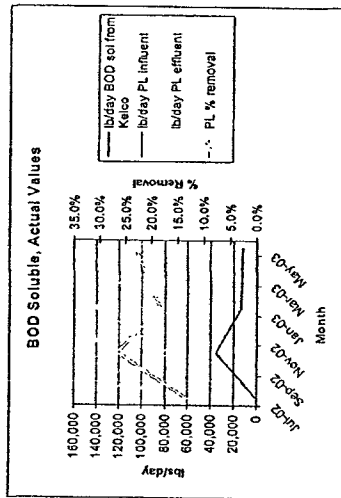


52051

WW Hot 02_16_06

WASTEWATER0004306

Daily Values, flows, and % removal			
14-May-03	131603.9538	1035875.3826	18.6%
30-Jan-03	121510.2972	83972.7912	30.8%
31-Oct-02	146558.8532	122072.2464	16.7%
30-Jul-02	85662.9756	80143.4066	29.8%
Average	121.335	93.016	24.2%
Median	12.853	94.924	24.7%
Maximum	35.137	122.072	30.9%
Minimum	40	60.143	16.7%



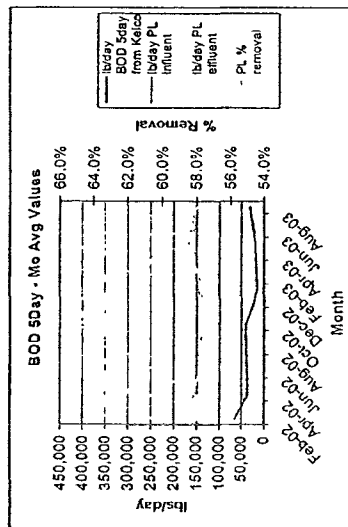
52051

WW Hat 02_16_06

WASTEWATER0004307

Monthly Average Values and Flows

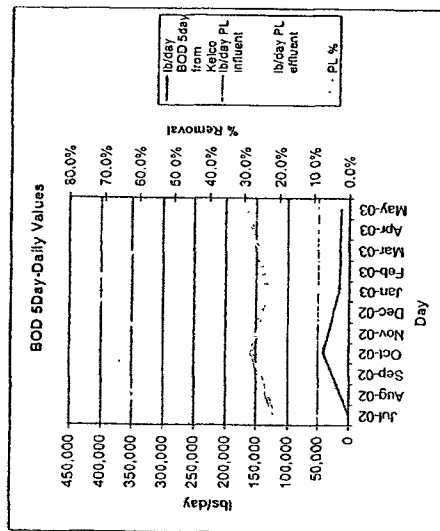
	lb/day BOD 5day from Kelco	lb/day PL Influent	lb/day PL effluent	PL % removal
Aug-03	31,400	387,417.186	148,652.126	61.4%
May-03	19,293	393,481.2	163,013.64	58.6%
Jan-03	13,913	383,481.2	140,329	64.3%
Oct-02	39,862	375,149.88	131,997.18	64.8%
Apr-02	35,367	365,231.952	153,462.688	58.0%
Feb-02	65,226	365,231.952	153,462.688	58.0%
Average	34,177	379,999	148,653	60.8%
Median	33,384	381,284	151,567	60.0%
Maximum	65,226	383,481	163,014	64.8%
Minimum	13,913	365,232	131,997	58.0%



5205
WW Hot 02-16_06

Daily Values, flows, and % removal

14-May-03	13,214	372032.388	163538.308	56.0%
30-Jan-03	15,149	405861.178	132076.41	67.5%
31-Oct-02	40,629	372401.016	157285.736	57.8%
30-Jul-02	40	342100.128	120010.832	64.3%
Average	17,508	373,124	143,255	61.5%
Median	14,681	372,217	144,666	61.3%
Maximum	40,629	405,961	163,638	67.5%
Minimum	40	342,100	120,011	56.0%



520589

WW Hot 02_16_06

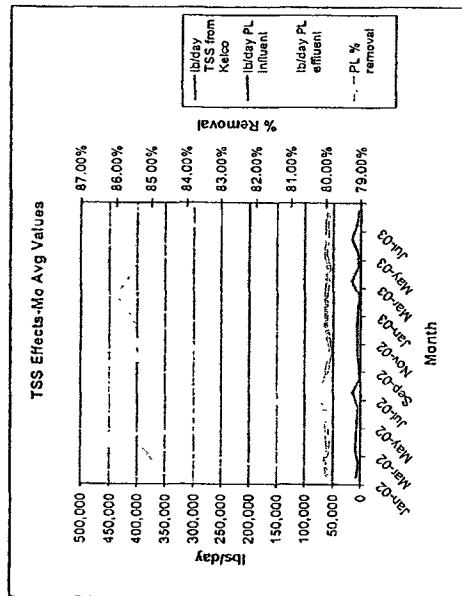


WASTEWATER0004309

5205
WW Hot 02_16_06

Monthly Average Values and Flows

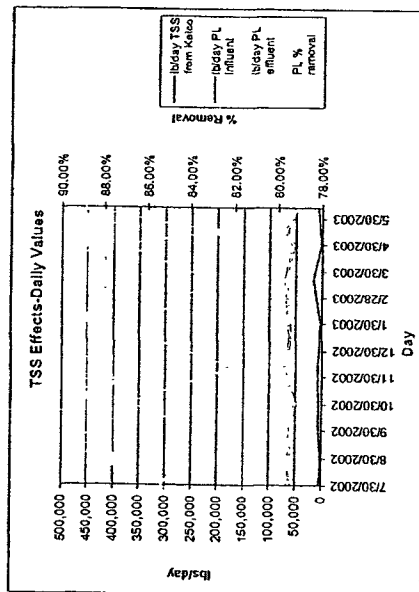
	lb/day TSS from Kelco	lb/day PL Influent	lb/day PL Effluent	PL % removal
Aug-03	4,006	402716	58025	85.50%
Jul-03	7,097	409310	61744	84.50%
Jun-03	15,270	400802	60305	84.90%
May-03	5,669	411072	64472	84.10%
Apr-03	4,812	408340	58171	85.70%
Mar-03	15,634	417811	58087	85.80%
Feb-03	3,146	438223	63764	85.30%
Dec-02	6,391	404128	63487	84.20%
Nov-02	5,825	386026	54789	86.20%
Oct-02	2,051	403193	53708	83.60%
Jul-02	1,442	446356	72790	84.30%
Jun-02	5,502	422841	65327	84.30%
May-02	9,332	386851	68884	84.80%
Apr-02	4,359	386257	61185	82.00%
Mar-02	7,255	401287	57854	85.30%
Jan-02	7,400	408233	61894	84.73%
Average	5,225	405193	61744	84.80%
Median	15,634	446356	72790	86.20%
Maximum	2,051	386257	64789	82.00%
Minimum				



5205L
WW Hot 02_16_06

Daily Values, flows and % removal

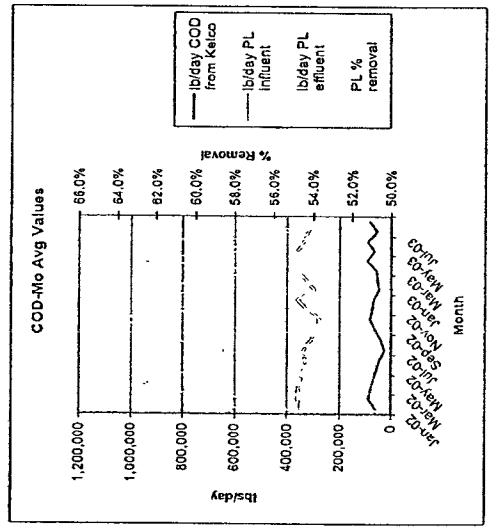
15-Jun-03	7,821	422000	47043	88.90%
15-May-03	3,844	401334	68722	82.80%
28-Apr-03	2,222	423182	54286	87.20%
20-Mar-03	13,461	408088	66672	83.10%
30-Jun-03	2,883	450450	62692.51	86.11%
15-Jun-03	7,003	426091	59832.884	86.00%
15-Jun-02	7,970	416430.38	74437.80	82.12%
31-Oct-02	8,890	380514.87	80058.14	86.85%
11-Oct-02	8,890	334117.82	59848.38	84.79%
22-Aug-02	1,651	388992.75	81238.06	84.68%
30-Jun-02	4,507	426143	62451.550	85.34%
Average	5723	412208	60815	85.27%
Median	4507	416430	61238	85.34%
Maximum	13461	450450	74438	88.90%
Minimum	1631	380315	47043	82.12%



5205L
WW Hot 02_16_06

Monthly Average Values and Flows

	lb/day COD from Kelco	lb/day PL Influent	lb/day PL effluent	PL % removal
Aug-03	81,826	717,091,034	31,600,756	55.5%
Jul-03	52,284	711,344,288	31,655,208	56.1%
Jun-03	51,223	821,240,85	35,974,124	59.0%
May-03	63,438	847,168,71	37,739	57.3%
Apr-03	91,872	987,751,252	35,852,012	63.1%
Mar-03	55,554	828,165,336	29,721,12	56.6%
Jan-03	47,232	783,327,69	29,721,12	52.2%
Dec-02	66,269	867,195,684	38,146,126	55.5%
Oct-02	80,910	761,115,312	27,519,512	63.9%
Aug-02	39,985	715,0315	30,871,344	51.7%
Jul-02	25,604	817,925,404	33,871,993	56.7%
Jun-02	44,332	602,420,59	37,739	63.1%
Mar-02	79,022	987,751,232	35,852,012	56.6%
Feb-02	65,846	839,165,336	35,852,012	56.2%
Jan-02	58,205	859,727,28	33,577,5	59%
Averages	64,314	825,054	33,577,5	59%
Median	63,438	821,261	33,871,993	59%
Maximum	91,872	987,755	361,446	64%
Minimum	25,604	711,345	27,5110	55%



5205E

WW Hot 02_16_06

WASTEWATER0004313

Daily Values, flows, and % removal

10-Jun-03	48,527
16-May-03	48,163
29-Apr-03	52,043
20-Mar-03	55,859
28-Feb-03	47,539
30-Jan-03	60,612
14-Jan-03	6,004
10-Dec-02	117,700
31-Oct-02	33,841
11-Oct-02	18,082
23-Aug-02	28,839
30-Jul-02	46,585
Average	47,539
Median	117,700
Maximum	6,004
Minimum	

1019196
849771
388310
309681
61.9
63.56

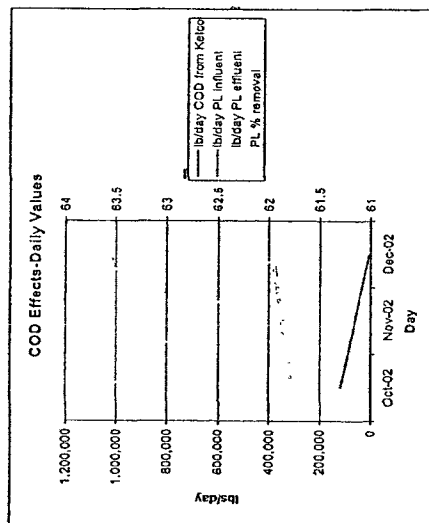


EXHIBIT 4

267770

Email message text

Object type: [GW.MESSAGE.MAIL]

Item Source: [Sent]

Message ID: [3EF1A227.CCP.TREASURE.100.1383633.1.4BF8.1]

From: [Eric Adachi]

To: [;Barbara Sharatz;BSharatz@sandiego.gov]

Subject: [Delimex questions]

Creation date: [6/19/2003 11:44:39 AM]

In Folder: [Mail Box]

Attachment File name: [c:\44923\EAdachi\1373.1-What is the legal basis for the city rates.doc]

Message: [

Barbara,

I'm not sure what answers you got from MWWD but this is what I came up with. Feel free to combine with Hedy's answers as you see fit.

Eric

]

WASTEWATER0002212

1. What is the legal basis for the city's user charge system? Is it an ordinance adopted by the City Council? When was the ordinance last updated?

A: THE CITY OF SAN DIEGO'S MUNICIPAL CODE SEC. 64.0404(a) PROVIDES THE LEGAL BASIS FOR THE ESTABLISHMENT OF SEWER SERVICE CHARGES AND WAS ADOPTED ON JUNE 6, 1983.

2. How are the formulas and rates in the charge sheet determined? Are they based upon some determination of capital and operating cost? How frequently are the rates updated and for what reason? Before updating does the city notify users and invite comments?

A: RATES ARE ESTABLISHED BASED UPON AN ANALYSIS OF THE SEWER SYSTEM'S CAPITAL AND OPERATING COSTS, USING INDUSTRY ACCEPTED METHODS PERIODICALLY VALIDATED BY FORMAL RATE OR COST OF SERVICE STUDIES. RATES ARE TYPICALLY INCREASED ONCE PER YEAR. PURSUANT TO REQUIREMENTS OF PROP. 218 ALL PROPERTY OWNERS ARE NOTICED AT LEAST 45 DAYS IN ADVANCE OF A PUBLIC HEARING AT WHICH THEY ARE INVITED TO PROVIDE INPUT. IN THE PAST, THE CITY COUNCIL HAS ADOPTED MULTIPLE, ANNUAL RATE INCREASES VIA A SINGLE RESOLUTION RATHER THAN ADOPTING SEPARATE RESOLUTIONS EACH YEAR.

3. Is a copy of the ordinance and charge system available for review? How can we obtain?

*A: THE COMPLETE CITY OF SAN DIEGO MUNICIPAL CODE IS AVAILABLE ON-LINE VIA THE OFFICIAL CITY WEBSITE AT:
<http://www.sannet.gov/index.shtml>*

ALTERNATIVELY, THE MUNICIPAL CODE CAN BE VIEWED IN THE CITY CLERK'S OFFICE.